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DEVELOPMENT OF THEORY OF INTEREST IN ACCOUNTING —A CRITICAL STUDY—

By Toshiyoshi OKABE*

I Whereabouts of Issue

I have long since been considering the problem of *shifting profit into expense* and insisting upon it on the basis of the formula provided by Marx with regard to the commodity-value reading $W=c+v+m$ (commodity-value=constant capital value + variable capital value + surplus value). It can be said that this article is in direct connection with this matter or rather it has the shifting of profit into expense as its starting point. Therefore, I would like anyway to clarify in advance wherein the issue lies which is to be dealt with in this article, concentrating first on that point.

1. Originally, according to the aforesaid formula prescribed by Marx reading $W=c+v+m$, what capitalists (enterprises=capitalist enterprises) *themselves* need to expend for the production of commodities is just the portion $c+v$ (speaking of the invested capital itself, the portion of productive consumption of the constant capital and variable capital) which they themselves have disbursed in the commodity-value. Or, viewed from the side of the productive elements, it consists only of the expense due to the means of production (Pm) and the expense which is wages necessary for labour force (A), as is known from the process of capital

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movement $G - W \left\langle \begin{smallmatrix} Pm \\ A \end{smallmatrix} \dots P \dots W' - G' \right.$. Moreover, what *they themselves* need to expend as expense (consumption of invested capital) *on their own account* in the process of reproducing commodities or in the management of the enterprise *involves nothing but* such a portion of $c + v$ (in other words, the expense due to the means of production (Pm) and the expense which is wages necessary for labour force (A)). This is to be considered as a matter of course so far as is seen from the process shown above $G - W \left\langle \begin{smallmatrix} Pm \\ A \end{smallmatrix} \dots P \dots W' - G' \right.$. It is also to be known from such a fact what sort of thing the expense capitalists *themselves* need to pay originally is. And it is a point of particular importance that we should confirm here first of all that originally speaking, it is just $c + v$ as mentioned above, that is, c , v alone. By the way, the expense in its original sense (or the original expense) referred to hereafter in this article denotes such c , v as capitalists themselves need to expend.

Apart from the case of Marxist economics, however, various things other than such c , v are usually considered as expense as if it were a matter of course, especially in accounting, as is generally the case from the point of view of economics. When we see them now, especially centering on the former, that is, the case of accounting, we can cite as their major examples, for instance, interest (especially interest on borrowed capital), rent (in the case of leased land; the same is applicable hereafter), premium (that on insurance for the property of an enterprise: ditto), expense for depreciation of intangible asset=rights, pure circulation expense (purely commercial expense to be appropriated exclusively for the realization of the value of commodities), taxes (part of them, however: the same is applicable hereafter), or, in addition, entertaining expense (amusement, eating and drinking expense, secret service fund, other), donation and so on. Viewed from what was mentioned above, however, they do not in fact constitute the expense in its original sense. As is evident when we turn to the financial resources from which they are disbursed or handled—with the exception of such a special case where the principal (invested capital)¹⁾ is eaten into and decreased

1) What is referred to as principal (invested capital) here is, according to the concept in accounting, something which should be grasped as *property* (*asset*). The one which is referred to here is also that which is observed on a periodical basis, and, speaking of each period concerned, it represents that which has been carried over from the previous period (that is, the whole of the property at the beginning of the period) respectively, so that what is attributed to the business profit obtained in each period concerned is not included in it. In this case, however, it is needless to mention that an increase or decrease brought about during the period in such principal itself as property must be considered by means of addition or reduction, respectively. However, the concept of principal is used in another sense—in the sense of principal as owned capital—in a later place (Section IV).

by them—we must say that each of them, in fact, is to be understood to be dealt with originally and generally by an appropriation of the profit (which is obtained in each period concerned). Originally, with regard to them, so far as we presuppose the case of an ordinary business management in which the principal at least is maintained as it is and does not come to be deficient as a result of their flowing out of the enterprise after they have been disbursed or handled (hereafter in this article, such a usual management of an enterprise is presupposed), we cannot but look upon each of them as being due to the profit (which is obtained in each period concerned), as stated above. And, as a matter of fact, unless we interpret them in that way, we shall be bound to find it impossible to explain the financial resources from which they are disbursed or handled. (Although, in order to interpret those things such as interest, etc. in such a way as shown above, we must assume that each of them is not contained in the existing assets, especially inventories, by being regarded as cost in the cost accounting. Originally speaking, furthermore, these things are to be dealt with in that way.)

As is known from that was seen above, those including interest and the others which were referred to above, are, when viewed from their inherent character, to be *generally* understood to be disbursed or handled from the profit, not having any meaning as the original expense at all. Ordinarily, however, little regard is paid to the real contents of those things, but each of them is taken as expense, as it were simply. (Such a fact is observed in reality both in science and in practice, though *profit and expense* are originally quite different categories.) And what I call the *shifting of profit into expense* points to nothing else but such a fact that what is originally profit is taken as expense. And, in my case, I have prescribed the portion which is originally profit but which is taken as expenses to be *that of profit which is shifted into expense*, and those including interest and the others which were referred to above are cited as major examples of such a portion of profit which is shifted into expense.

2. The problem which comes up here from the viewpoint of accounting is how to look upon the aforesaid portion of profit which is shifted into expense when we think of the *profit of an individual enterprise* as a individual economy, which is different from that in the case where it is viewed socio-economically or from the standpoint of the society as a whole (in this respect, see the later description), that is, what is called *business profit* in accounting. And, in other words, this also means nothing else but how it should be grasped in the profit and loss accounting in an individual enterprise which is aimed at computing such business profit (more generally speaking, business profit and loss) and which is done in

a relationship of revenue—expense=profit or loss. Or, more concretely speaking, we can say that the abovementioned problem will be presented in such a form that the portion of profit shifted into expense which was stated above should be regarded as still belonging to profit=business profit even in the profit and loss accounting of such an enterprise in as much as it originally means profit or that it should be understood according to another way of thinking in this kind of accounting. Rather here, we shall have to say that the very point like that is raised as an important problem we should look into closely.

In any case, depending upon how we should look upon such a portion of profit which is shifted into expense, the scope of the *expense* in the profit and loss accounting naturally differs and then, as a result, the size of what is grasped as *profit* (business profit) is naturally bound to be different. And in our case, what becomes especially an issue here is, indeed, just such a point.

However, when I have in mind such a problem in accounting as stated above now, I divided the aforesaid portion of profit which is shifted into expense into two parts, and I have maintained that one part, e.g., interest (especially interest on borrowed capital), rent, expense for the depreciation of intangible assets=rights, pure circulation expense and so forth should be regarded as the *portion to be deducted from the revenue=expense* and the other part, e.g., premium, taxes, entertaining expense, donation and so forth still as *profit=business profit*—therefore, those belonging to them which have been disbursed (or those dealt with in accounting to be disbursed) as the *items of appropriation of profit*—(the *theory of dichotomy of the portion* of profit which is shifted into expense, in my view). And it may be said, first of all, that this constitutes the main point of my insistence on a series of profit which is shifted into expense²⁾.

3. The interest I am going to deal with in this article constitutes a phase of particular importance in the portion of profit which is shifted into expense as mentioned above. Originally, how we should look upon interest has so far been discussed a great deal, in particular in accounting also, but we cannot say even today that the issue has been solved. Rather we shall even have to say that there still remain a lot of issues. In this article I will take up such a problem concerning interest in ac-

2) For more details of my own view concerning the way of thinking about the shifting of profit into expense or the portion of profit shifted into expense which I discussed above, see the following written by me: "Theoretical Character of Accounting", (1), (2), *Accounting (Kaiki)*, Jan., Feb. 1952; "Rate of Surplus Value, Rate of Profit, Rate of Business Profit", *Economic Review (Keizai-Ronso)*, Dec. 1953; "Problems in Business Profit Calculation", *Economic Review (Keizai-Hyoron)*, Oct. 1958. It is added that the last one especially deals with the insistence on the aforesaid dichotomy.

counting as the one especially in the theory of profit and loss accounting in such a way of thinking as stated above, and will try to further clarify my own view on it more or less concretely, scrutinizing various other theories, as will be seen hereafter³⁾.

II The Theory of Taking Interest on Borrowed Capital as Expense and the Theory of Taking Interest as Profit

1. Now, interest in accounting usually is roughly classified into interest on borrowed capital (interest to be paid) and interest on owned capital (interest to be computed). In my opinion, however, the one of these that we have to delve into as the portion of profit which is shifted into expense is the former interest on borrowed capital (cf. the theory of dichotomy stated above). Therefore, I will first consider such interest on borrowed capital herein below. From the point of view of the portion of profit which is shifted into expense, interest on owned capital also never fails to be a problem, but rather, as seen from the insistences by some disputants (especially those who insist that not only interest borrowed capital but also interest on total capital inclusive of owned capital should be considered as expense), it should also be taken up as an important subject of discussion, but I will consider this interest on owned capital separately at a later stage (Section IV).

Speaking of the abovementioned interest on borrowed capital, it is generally described widely in accounting, as is well known, that only this exclusively is to be considered as expense in profit and loss accounting (affirmation of a character of profit involved in interest on owned capital: negation of its character of expense, but *insistence instead on a character of expense involved in interest on borrowed capital alone* in the profit and loss accounting). In other words, as viewed from its being a problem in the profit and loss accounting, it may be said that with regard to interest, such a view—which is called the *theory of taking interest on borrowed capital as expense* hereafter—is a popular one in accounting. As seen

3) What has so far been dealt with as an issue of interest in accounting is handled mainly as a problem in the cost accounting, i. e., a problem centering around what about the *character of cost* of interest. It cannot be said that the problem of interest in the profit and loss accounting has been discussed so much thus far, in spite of its importance. Such a situation is one of the reasons why I have taken up interest in question as an issue in the profit and loss accounting in this article. In any case, however, I will not touch on an issue of interest in the cost accounting in this article as I have taken it up as a problem in the profit and loss accounting in that way.

If I am allowed here to give only the conclusion drawn from my own view concerning what about character of cost of interest, I shall be bound, in this respect, to support the theory in the negative as to interest in general. The basis on which I have said that way is to be known by what I will explain hereafter.

from what has already been touched on, moreover, my own opinion also, as one concerning interest in accounting, is in favour of such a theory of taking interest on borrowed capital as expense in the long run. In accounting also, however, we have often encountered the insistence, though that of a minority, on the other hand, that neither interest on owned capital nor interest on borrowed capital is expense, but that they constitute part of business profit and, accordingly, that both of them should be dealt with naturally in such a way also in the profit and loss accounting in an enterprise⁴. And this sort of view may be called the *theory of taking interest as profit* in the light of such a purport⁵.

4) A. L. Dickinson, *Accounting Practice and Procedure*, 1914, pp. 200-202; Ditto, "The Fallacy of Including Interest and Rent as Part of Manufacturing Cost", *Journal of Accountancy* (J. o. A.), Dec. 1911, pp. 588-593; P. M. Atkins, *Textbook of Industrial Cost Accounting*, 1924, pp. 235-244; W. B. Costenholz, "Is Interest on Invested Capital a Cost?", *J. o. A.*, Apr. 1918, pp. 248-254; American Accounting Association (AAA), W. A. Paton, and A. C. Littleton, each of the books cited next, W. Wehe, *Der Kapitalzins als Gewinnfaktor*, 1939, S. 7 ff.; E. Schiff, *Die Wertminderungen an Betriebsanlagen in wirtschaftlicher rechtlicher und rechnerischer Beziehung*, 1909, SS. 31-32; K. Klinger, "Die Verzinsung des Eigenkapitals in der Selbstkostenrechnung unter Berücksichtigung ihrer Bedeutung für die kalkulatorische Fabrikbuchhaltung", *Zeitschrift für Betriebswirtschaft*, 4. Jahrg., 1927, SS. 701-702. (It can be said, however, that his view of taking interest as profit is not necessarily consistent.) See, in addition, R. Yoshida, *A Study of Indirect Cost*, 1936, Part II, Chap. 5; O. Kubota, *Theory of Indirect Cost Accounting*, 1942, Part III, especially Chap. 9; F. Sakamoto, *Modern Management and Cost Theory*, 1957, Part III, etc.

5) As one of the representative views in relatively recent years in favour of such a theory of taking interest as profit may be cited, for instance, that of AAA (especially that which is given in the *Accounting and Reporting Standards for Corporate Financial Statements*, 1957 Revision). Therein, however, while in favour of the theory of taking interest as profit, AAA is merely making such insistence, without clarifying the basis of its argument (cf. AAA, *Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements*, 1957, p. 5). In this case also, however, I think that we may conclude that as the basis of its argument, something is being thought of which is similar to the case of Professors W. A. Paton and A. C. Littleton to which I am going to refer next. In any case, however, both of the professors, who also belong to the group of the representative disputants in favour of the theory of taking interest as profit, not only regard the interest in question as profit but also they are rather taking the following way of thinking as an especially important basis of argument when they adopt such a point of view. Accordingly, I must touch more or less on this point here.

It is to be remembered, however, that what is a problem to them in this case—they take it as already self-evident that interest on owned capital is profit (it is understood at least that way)—is especially interest on borrowed capital only. And they argue that, whether to regard it as expense or profit in the profit and loss accounting is, in the first place, dependent upon what kind of "fundamental point of view" is taken as the way of viewing an enterprise, and in accordance with such a way of thinking, the interest on borrowed capital in question is regarded as expense (outlay as expense) from "the strictly proprietary standpoint" on the one hand and it represents not expense but a distribution of profit when seen from "the point of view of the enterprise as an economic entity and center of managerial activity" on the other. In their case also, when they are discussing the aforesaid interest on borrowed capital, they insist that it differs according to the differences in such points of view whether it is expense or profit, and yet they themselves do not declare conclusively which of these should be favoured (W. A. Paton and A. C. Littleton, *An Introduction to Corporate Accounting Standards*, 1940, pp. 43-44). However, by way of the viewpoint from which it is observed

2. However, when it is viewed as a problem in accounting, is it possible to accept as it is the theory of taking interest as profit as mentioned above which grasps all interests—including up to interest on borrowed capital—as an individual enterprise's profit=business profit? Here I have, to begin with, to touch on that point anyway, though briefly.

As is known from what has already been described, in so far as it is essentially on capital, interests generally, therefore, whether it is interest on owned capital or interest on borrowed capital, all, originally speaking, constitute part of profit. It is indisputable that whichever interest of these it may be, we can hardly think of it originally without taking profit (surplus value) as its basis or premise. And in this case also, this should first be made clear. In the light of such a fact, it is true that the aforesaid theory of taking interest as profit held by the disputants apparently seems to be well founded.

However, what we must further consider here as to the theory of taking interest as profit is that, when we take up *profit* as the object first of all in view of the relationship with the problem concerned, the one which becomes an issue here now in our case—accordingly in accounting—is profit in an individual enterprise as an individual economy or business profit that is originally to be dealt with in this science. In other words, furthermore, it is nothing else but what is considered to belong to such an individual enterprise as a specific surplus (in this respect, see what is stated later, however). However, in that it belongs to an individual enterprise in such a way, even if it is grasped equally as profit it should be regarded in its conception as clearly different from the one viewed socio-economically or from the standpoint of the society as a whole (it here represents that which falls under the portion m in the relationship $W=c+v+m$), or, to put it more concretely, we must say that it should be understood to possess a more restricted meaning against the one in the case where it is viewed in such a socio-economic way. From this, moreover, in case we take up the problem of such profit in an individual enterprise=business profit, the way of thinking which takes

about an enterprise—therefore it also becomes an issue in accounting—they are stressing that something like the latter mentioned above should be adopted (W. A. Paton and A. C. Littleton, *ibid.*, pp. 8-9), so that, judging from this, in their case, it will not be wrong to conclude that interest on borrowed capital is naturally considered as profit from such a point of view as referred to above. It may also be said that so far as is seen from their way of thinking, it is rather a matter of course that we can interpret it in that way. Speaking of Professor Paton himself in particular, it may be said that with regard to interest, he has been basically following such a way of thinking as mentioned above ever since his early career until the present time (cf. W. A. Paton and R. A. Stevenson, *Principles of Accounting*, 1918, pp. 198-200, 613; W. A. Paton, *Advanced Accounting*, 1941, pp. 472-473; W. A. Paton and W. A. Paton, Jr., *Corporation Accounts and Statements*, 1955, pp. 274-276).

the matters stated below into consideration is still to be naturally introduced in connection with the way of understanding interest on borrowed capital concerned—socio-economically, or, originally speaking, this also clearly constitutes part of profit, however—unlike the case of interest on owned capital on the other hand. Speaking from the other side of the matter, this is also naturally associated with the problem of *expense* (concept of expense) as an individual economic one as is mentioned in accounting (in the relationship $\text{revenue} - \text{expense} = \text{profit or loss}$). Generally speaking, however, we shall have to say that the abovementioned theory of taking interest as profit cannot be accepted at least as a view in accounting in that it pays no regard to those matters, and as a result forgets about the distinction between the one which should be considered socio-economically as *profit* or *expense* connected therewith and the one which should be considered from the individual economic point of view.

Speaking of the views of both Professors W. A. Paton and A. C. Littleton, as touched on in the notes before (and of the American Accounting Association which is understood to be adopting the same way of thinking as theirs), moreover, even if we adopt “the point of view of the enterprise as an economic entity and center of managerial activity” in the way of viewing an enterprise and therefore as a position which will become a problem in accounting, as they say, it never follows from it that we should regard interest on borrowed capital as profit just as a matter of course. Even from such a point of view, it will be sufficient if we put the interest on borrowed capital once handled as expense back to “profit” again, if necessary. And when viewed in this way, it may be said that their insistence as stated above will be easily attained by such a techincal way of dealing with it in accounting, irrespective of it in particular.

3. However, even with regard to the popular view that interest on borrowed capital alone should be taken as expense in the profit and loss accounting (the theory of taking interest on borrowed capital as expense), we cannot say that the problem has been fully clarified. What comes into question to us in particular in this case is the *basis of their argument* which is referred to when such a popular view is maintained, but this point, in fact, is not delved into enough to be worth mentioning. And in this case, we may say that it is even rather a commonplace that the disputants hold, as if it were self-evident, that interest on borrowed capital constitutes expense, although in this case also, the basis of argument on which interest on borrowed capital is taken as expense in such a way is in no sense left unquestioned. Among some of the disputants,

in reality, this point is clearly taken up as an issue. In such a case also, however, what these disputants usually maintain as the basis of argument described above, in short, means, it may be said, that unlike interest on owned capital, interest on borrowed capital requires *monetary outlay*, i.e., that it means, as it were, such a *nature of outlay* involved in interest on borrowed capital⁶⁾. In any case, however, this point, so far as it is discussed, is that which is taken as an especially major basis of argument in the theory of taking interest on borrowed capital as expense, and, therefore, we, on our part, shall have to take it up as the one we need in particular here. Then, however, is it possible to take such a character of outlay involved in interest on borrowed capital as the basis of argument on which to insist on its nature of expense? I cannot think of it in that way at all.

In this case, in particular, the disputants look upon interest on owned capital as if it were not disbursed at all, but we shall have to say that in the first place this point is already opposed to the fact. It is true that interest on owned capital is not disbursed under such a name, or, as it were, in itself. When we see it in the case of a joint-stock company in particular now, however, it is customary that even such interest on owned capital, in part or in whole, is included in dividends or paid as what corresponds to it. Accordingly, even interest on owned capital, especially in the case of a joint-stock company, must be regarded, generally in fact, as that which is disbursed in the form of dividends. Even when we view it in the case of other joint enterprises, on the other hand, the same is still naturally to be thought of, even though it is not in the form of dividend. Dividend (or others of profit distributive nature) is, unlike interest, dependent upon the amount of business profit, but nevertheless the principle is that it is paid generally so far as a joint-stock company (or other joint enterprises) is concerned. The same can be said substantially in the case of private enterprise, too.

Viewed from such a fact, therefore, it is to be easily understood at a glance that it is wrong to insist on the character of expense exclusively

6) G. S. Armstrong, *Essentials of Industrial Costing*, 1921, pp. 179-184; J. P. Jordan and G. L. Harris, *Cost Accounting*, 1921, pp. 430-431; W. B. Lawrence, *Cost Accounting*, Rev. ed., 1937, pp. 417, 422; F. Leitner, *Die Selbstkostenberechnung industrieller Betriebe*, 9. Aufl., 1930, SS. 62-65; E. Kosiol, Aufwand, in H. Nicklisch, *Handwörterbuch der Betriebswirtschaft*, 3. Aufl., 1957, S. 281; L. Jung, *Der Kapitalzins in der industriellen Selbstkostenrechnung*, 1926 (according to Klinger, *a. a. O.*, S. 694, however); R. Yoshida, *op. cit.*, pp. 89, 96. In addition, cf. E. C. Gause, "Relation between Interest and Manufacturing Costs", *J. o. A.*, March 1918, pp. 187-190; W. Wehe, *a. a. O.*, SS. 67-68; K. Mellerowicz, *Kosten und Kostenrechnung*, I, 2. Aufl., 1951, SS. 61-62; A. Schnettler, Zins (ohne Zinstheorien), in H. Nicklisch, *a. a. O.*, SS. 6583-6585; F. Sakamoto, *op. cit.*, Part III, Chap. 3; O. Kubota, *op. cit.*, Part III, Chap. 6, etc.

with regard to interest on borrowed capital alone on the theoretical basis of its character of outlay. Or, furthermore, from the point of view of its character of outlay, when dividend and so forth have been paid in reality, how do the disputants look upon this fact? This also will naturally never fail to become another issue.

III Basis of Argument of the Theory of Taking Interest on Borrowed Capital as Expense

1. How then will the character of expense of interest on borrowed capital be explained? In my opinion, it should be considered generally in such a way as stated below and it must be said that it is hard to consider it except in such a way.

As is well known, according to the fundamental classification of capital in the capitalist economy of today, there exist separately various capitals with the industrial capital as their center, commercial capital and loan capital. As the one which should be considered here in particular, there exists land (especially leased land) in addition to them. And from such a fact, surplus value or profit which is created originally by industrial capital cannot be the one that belongs to industrial capital alone. It is already known to people that it is separated into industrial profit, commercial profit, interest and rent on the abovementioned industrial capital, commercial capital, loan capital and land, respectively, and is made to belong to each by what is called the form of ramification of profit (surplus value). In this case, moreover, interest and rent are due to such particular economic relations as the *lending and borrowing* of loan capital in the case of the former and the possession of land and its unequal fertility and location in the case of latter—and furthermore its *leasing and renting* especially in the case of leased land—, in other words, they are necessarily produced from these matters⁷⁾.

7) Thus, profit attributable to industrial capital, commercial capital, loan capital and land, i. e., industrial profit, commercial profit, interest and rent may be called by us the first attributable profit in the sense that the total of surplus value or profit produced socially as a whole is *first* made attributable to every obtaining body (attributable body) such as industrial capital and so forth as cited above. Speaking of *income* as profit, furthermore, it may be said that this corresponds to what is through the so-called first distribution.

In this case, the reason why these industrial profit, commercial profit and so forth are called the first attributable profit in such a way is that these are further distributed or disposed of in the forms of taxes and dividend and in various other forms, respectively. Such dealings as are seen in this case, however, are only taken on that profit which was once attributed to every obtaining body mentioned above (the first attributable profit), and, moreover, it will be necessary in particular here to make this clear-cut. So far as is seen in such a way, furthermore, those like the abovementioned taxes, which are often identified with the abovementioned interest, rent (especially that in the case of leased land) and so on and therefore regarded as expense (an enterprise's expense) from the point of view that they are equally borne by the enterprise, must be thought to be naturally differentiated from interest, rent and so on. It is added that with regard to dividend, you will find the explanation later.

2. What was called loan capital above, meanwhile, represents, in my case, from the standpoint of capital referred to in accounting in an individual enterprise, borrowed capital or that which corresponds to what is grasped usually as the so-called debt. (In this respect, see the place in a later part dealing with the way of understanding owned capital.) Accordingly, what is called interest on borrowed capital should in fact be regarded as what is paid to such borrowed capital as loan capital in the form of price or reward for the utilization of its value of use (as the one of producing surplus value or profit) transferred over for a specified period of time. And its payment is just made originally in such a relationship as mentioned above.

Therefore, on the basis of such a fact now, apart from all the other points here for the present in respect of an enterprise and with only the classification of capital involving *owned capital* and *borrowed capital* concerned directly with the problem we are faced with in mind, it must be seen that there are presupposed *two separate persons* in advance for an enterprise which is the borrower of borrowed capital, as *the person of obtaining* surplus value or profit (the *obtaining body*), that is to say, this sort of enterprise (borrower) and the owner or supplier of borrowed capital (lender). What is especially important that comes into question here to us, furthermore, is indeed the fact regarding the person obtaining such surplus value or profit. And, in other words, it must be said that this means that in the case of enterprises making use of borrowed capital, even if it is surplus value or profit they have originally created or obtained, part of it corresponding at least to the interest on the borrowed capital cannot be the one belonging to them from the beginning.

And, if it is to be viewed that way, then the one from which at least the interest on borrowed capital is deducted is to be considered as the profit to be obtained by an enterprise as an individual economy, that is, business profit. And, viewed from the standpoint of a problem in the profit and loss accounting of an enterprise, this means inevitably that the interest of this kind should naturally be made *an item to be deducted from revenue*. Viewed from this, furthermore, interest on borrowed capital should be regarded as being of the same nature as expense in the profit and loss accounting, and then it will naturally have to be recognized that it should be dealt with in that way.

3. When viewed on the basis of the formula $W=c+v+m$ which I took up as an issue before, what I must touch on further here in connection with the view that the interest on borrowed capital should be viewed in the abovementioned way is the relationship between the way of thinking as to such interest on borrowed capital (loan capital) and that

of commercial profit (on commercial capital).

As is already known, both of them are nothing but part of the surplus value or profit originally created by industrial capital, moreover, its each form of ramification to loan capital and commercial capital. In such a sense, therefore, they do not differ essentially in themselves. We can merely say that it is obtained (transferred) as *unrealized* value in the case of commercial profit (the realization of that which is left unrealized is naturally effected by commercial capital) and as *realized* value or in the form of money in the case of interest on borrowed capital.

Also, therefore, in the light of such a fact, when we now think of an enterprise run by industrial capital=productive enterprise, if the interest on borrowed capital which is paid therefrom is to be taken as profit of this sort of enterprise (industrial profit), the same will have to be said of commercial profit. However, nobody will probably insist that commercial profit should be taken as profit of a productive enterprise in that way. If it is so, furthermore, interest on borrowed capital is to be naturally excluded from being taken as profit of a productive enterprise. If commercial profit is excluded from profit of a productive enterprise and yet interest on borrowed capital is not handled that way, then we must say that there is clearly the lack of consistency in the logic. And in reference to interest on borrowed capital, when viewed from these matters, furthermore, it is to be understood probably more clearly that it is not unjustifiable at all to exclude it from taking it as profit of the productive enterprise concerned=business profit, in other words, to classify it as an item to be deducted from revenue in the profit and loss accounting of the enterprise. (In the case of interest on borrowed capital, however, unlike the case of commercial profit, it is just because it is handled as the *realized* value that it is to be classified as an item to be deducted from revenue in the profit and loss accounting in such a way.) As is known inferring from the above statement, moreover, such a way of thinking about interest on borrowed capital is, it must be said, equally applicable to other enterprises as well as to a productive one.

4. And in my case, it is fundamentally based upon the arguments given above that while maintaining that interest on borrowed capital originally constitutes part of surplus value or profit, I am of the opinion that it should be taken as expense in the profit and loss accounting of an enterprise as an individual economy. In this case, however, what I refer to as expense in respect of interest on borrowed capital, is, I must say, not one as cost (cost, especially manufacturing cost or cost of production, in the cost accounting) but that it should be regarded as one kind of non-operating expenses. It is because interest on borrowed

capital, as is clearly seen from the observations made so far, is not a necessary expense at all originally in itself not merely in production but also in the phases of circulation and general management of an enterprise⁸⁾⁹⁾.

IV Criticism of the Theory of Taking Interest on Total Capital as Expense and the Theory of Taking Dividends as Expense

In the above statements (Section II and III), I have insisted that when viewed as the problem of an enterprise as an individual economy=the problem in accounting, despite that interest on borrowed capital and interest on owned capital both originally constitute part of surplus value or profit socially, they are rather different, thus approving a character

8) Also in the case of scholars of accounting based upon the Marxist economics, so far as I know, they rather regard interest on borrowed capital as expense (an item to be deducted from revenue) at least in accounting, without taking it as belonging to profit, especially to business profit. For instance, Professors W. Kimura and K. Baba state as follows, respectively (what is called merely interest in the following can be justly interpreted to stand for interest on borrowed capital in each case). "Because interest is a partial share of profit, I do not mean to deny the reckoning of interest in production cost." (W. Kimura, "Items of Advance Payment of Profit in Periodical Profit and Loss Accounting", *Business Accounting (Kigyo-Kaikei)*, Feb. 1953, p. 6). "The justness of the recognition that interest is, after all, paid from the average profit.....does not necessarily prevent interest from being included in expense." (K. Baba, *Theory of Depreciation*, Rev. and enl. ed., 1956, p. 59).

Be that as it may, however, *why* do both of them adopt this view? It is this very point that is important here, but in the case of both of them, in fact, they merely state in such a way as referred to above, failing, to our regret, to touch on such a vital point as mentioned above. Especially in the case of Professor Kimura, we shall have to say that there is still left room for an issue to be raised when he goes so far as to recognize taking interest as *production cost*—apart from regarding it as expense—while he prescribes it as "an item of advance payment of profit".

Professor S. Neya also is one who regards interest on borrowed capital in particular as expense in accounting, while considering interest as profit economically from the standpoint of Marxist economics, and in this case the professor is seeking his theoretical basis for taking such a view concerning interest on borrowed capital in the point of view that accounting of today, so far as is seen in terms of the reckoning system, is the "means of computing profit attributable to owned capital" (S. Neya, *The Type of Appearance of Conservative Accounting*, 1961, its supplement, "Rescrutiny of Theory of Interest Accounting", p. 254 ff. By the way, this supplement deals with interest especially as an issue in the profit and loss accounting). (It is often encountered now also in the case of the other disputants that the accounting of today, especially the profit and loss accounting is characterized as having such a meaning.)

To view the accounting of today in that way, however, it may be said, means that it just grasps the facts being carried out by means of accounting today *merely as facts*, and moreover, to be exact at that, in the form not necessarily as it is. The very basis of such facts is, indeed, to be further questioned. In such a sense, in the case of Professor Neya also, I cannot but think that many issues is still left unsolved as to the essential basis of argument on which to take interest on borrowed capital as expense. And so far as interest is concerned at least, even if the "means of computing profit attributable to owned capital" of accounting is taken as the basis of argument, it is natural, in this respect, that we should go back to consider the economic facts involving the division of capital and ramification of surplus value or profit based there on that I myself have discussed so far.

of expense exclusively as to interest on borrowed capital alone. Then, how should interest on owned capital be considered?

1. On this point, I must first touch more or less on the views of the disputants. When I observed the views on interest in accounting earlier, I referred to the view in favour of taking both interest on borrowed capital and interest on owned capital as profit, especially as business profit (the theory of taking interest as profit) which is in opposition to the aforesaid theory of taking interest on borrowed capital as expense which I am also to support in conclusion though the basis of my argument differs from that of the other disputants. On the other hand, however, there is a view, which is exactly opposed to that, i.e., the view that all of these interests (accordingly, interest on total capital) should be taken as expense, strongly urged by some of the disputants¹⁰. This kind of view, in the light of such a purport, may be called the *theory of taking interest on total capital as expense*. (By the way, what constitutes at least one of the major parts of this theory of taking interest on total capital as expense is one that interest on total capital as what is called management capital is taken as cost in the cost accounting and at the same time this sort of cost is taken as expense in the profit and loss accounting, and accordingly, from the point of view of the cost accounting, it may be said that it corresponds to what we should call the theory of taking interest on total capital as cost in such a sense.)

The abovementioned theory of taking interest on total capital as expense, as is clearly seen, maintains that all the interests on the capital invested in an enterprise should be taken as expense, making no distinc-

9) In reference to the fact that in accounting today, dividend is dealt with as a distribution of profit and interest on borrowed capital as expense, Professor K. Yamashita states that "this is not based upon the essential difference between dividend and interest, but it arises only from the economic order in which the owner of capital and its functioner are separated" (K. Yamashita, *General Theory of Accounting*, 1959, p. 63), but it only seems to me rather strange that he brings up the matter of the separation of "owner" and "functioner" of capital here. Speaking in terms of "owner" of capital against its "functioner", the owner of owned capital and the owner of borrowed capital are originally the same, and, from this standpoint, accordingly, both dividend and interest on borrowed capital are to be handled in the same way. However, Professor Yamashita, instead, is using the fact of the separation of the "functioner" and the "owner" of capital which should originally be understood that way as the basis for explaining, as it were, the opposite of this. In that sense, such a way of thinking as held by Professor Yamashita is not merely hard to understand, but rather it cannot but be disregarded as sheer nonsense.

10) C. H. Scovell, *Interest as a Cost*, 1924, especially Chap. II, III; R. P. Soule, "Trends in the Cost of Capital", *Harvard Business Review*, March—April 1953, p. 33 ff.; F. Schmidt, *Kalkulation und Preispolitik*, 1930, SS. 55, 65–66; Derselbe, *Die organische Tageswertbilanz*, 3. Aufl., 1929, S. 158 (herein, however, he is describing, after all, such a way of handling as including only interest on borrowed capital as expense in the profit and loss accounting), S. 184; J. Moll, *Kosten-Kategorien und Kosten-Gesetz*, 1934, SS. 5–6; E. Hatheyer, *Vom Wesen der Kosten*, 1931, S. 17; T. Nakanishi, *Theory of Business Expense*, 1936, p. 55, etc.

tion between interest on borrowed capital and interest on owned capital. In such a respect, therefore, it is considered as being in opposition not only to the theory of taking interest as profit and the theory of taking interest on borrowed capital as expense which were referred to above but also to one other view¹¹⁾ supported as being influential in accounting which, while taking both interest on borrowed capital and interest on owned capital as cost in the *cost accounting*, denies the character of expense of interest on owned capital and takes interest on borrowed capital alone as expense in the *profit and loss accounting* (speaking from such a conclusive statement alone, this may also be called another sort of the theory of taking interest on borrowed capital as expense, but it is different from the theory of taking interest on borrowed capital as expense that has been discussed above in that it takes interest on owned capital as cost). According to a group of disputants, furthermore, it is insisted that *dividend* which comes into question in connection with interest on owned capital (especially that portion which is regarded as interest on owned capital that is included, in part or in whole, in it) should be looked upon not as a distribution of profit but as *expense* on the premise that interest on borrowed capital is naturally taken as expense¹²⁾. And in such a sense, it may be said that this sort of view can be called *the theory of taking dividend as expense*. (This kind of view, in the case of our country, is especially strongly supported of late by some people¹³⁾.) And it is often maintained, in the abovementioned theory of taking interest on total capital as expense or the theory of taking dividend as expense, that by way of the point which is considered as the especially important basis or premise on which such an insistence is founded, the interest or dividend concerned constitutes the so-called *cost of capital* which is regarded as the price for the service of capital or the expense for the utilization of capital¹⁴⁾. Moreover,

11) This view is that of taking interest on owned capital as so-called added cost (Zusatzkosten). As is well known, it is held especially by E. Schmalenbach and the various German scholars.

12) R. P. Soule, *op. cit.*, p. 33 ff.; E. Schmalenbach, *Dynamische Bilanz*, 11. Aufl., 1953, S. 163; Investigation Section of Economic Planning Agency (Japan), *Capital Accumulation and Business Management in Japan after the War*, 1957, pp. 148-150 (in the other part of this book, however, it is still adopting the opposite view of taking dividend as part of profit as the common view does, *ibid.*, p. 49); S. Watanabe, "Revaluation and Real Estate Tax", *Business Accounting (Kigyo-Kaikei)*, June 1950, p. 49. In addition, for instance, cf. L. H. Kimmel, *Taxes and Economic Incentives*, 1950, p. 22.

13) Securities Exchange Deliberative Council (Japan), *The Written Opinion (Response) about "On Promotion of Capital Increase"*, June 1961; Kansai Economic Federation (Japan), *Opinions concerning Revision of Taxes on Interest and Dividend*, Aug. 1960; Overall Policy Research Association (Japan, Head, H. Arisawa), *Proposition on Measures for Money and Capital Markets*, Jan. 1961 (the gist of this proposition is given in *Business Accounting (Kigyo-Kaikei)*, Mar. 1961), etc.

14) R. P. Soule, *op. cit.*, p. 33 ff.; Scovell, *op. cit.*, Chap. III; K. Mellerowicz, *a. a. O.*, SS. 61-65; Investigation Section of Economic Planning Agency (Japan), *op. cit.*, pp. 148-150;

in both of the theories, it may be said, this is already involved naturally in its fundamental purport even when it is not described explicitly in such a way as mentioned above. It may also be said that in the case of both the theories this point is nothing but the fundamental one characteristic of it. Be that as it may, how much worth mentioning is such a theory of taking interest on total capital as expense or a theory of taking dividend as expense? In this case, however, what comes into question with regard to the former theory of taking interest on total capital as expense is interest on owned capital as is clearly seen from the above statement, and therefore, so far as this theory of taking interest on total capital as expense is concerned, I will exclusively take up such interest on owned capital as a subject of discussion hereafter.

2. In the earlier statement I considered loan capital as meaning what corresponds to borrowed capital when viewed as to one in an enterprise. Indeed, it is nothing else but borrowed capital when spoken of from the side of an enterprise which is a borrower. That I have held that interest on borrowed capital should be regarded as expense in accounting, furthermore, is because of the fact that it cannot originally belong from the beginning to an enterprise which is a borrower in view of an particular economic relationship of lending and borrowing of borrowed capital (loan capital).

And in my case, the interpretation of loan capital as what was mentioned above implies, speaking from the other side of the matter, that *owned capital* as capital in an enterprise and therefore in accounting is not originally regarded as loan capital (borrowed capital, debt). The reason why I think of owned capital in this way is that it is not originally due to a particular relationship of lending and borrowing. According to what is being described frequently today, it is seen to happen widely that owned capital is regarded as if it were loan capital (borrowed capital) or that owned capital is identified with borrowed capital, but owned capital originally should never be regarded as loan capital (borrowed capital) and neither of them is the same although there is certainly found something in common or identity between that and borrowed capital. And speaking of both of these now, the difference of owned capital from borrowed capital (loan capital), especially the former individuality, particularity instead will have to be considered here.

Originally, this owned capital, especially when viewed as to the case

K. Tasugi, Problems on Capital Accumulation and Internal Reservation, in S. Takase (ed.), *Capital Accumulation and Company Management*, 1953, pp. 203-217, etc. In addition, for instance, cf. E. Schmalenbach, *Kostenrechnung und Preispolitik*, 7. Aufl., 1956, S. 320; F. Schmidt, *Die organische Tageswertbilanz*, 3. Aufl., SS. 156-157.

of a joint-stock company here also, is, first, generally divided roughly into capital stock and surplus, as is well known, and the latter is further divided into capital surplus and earned surplus. However, capital surplus of the latter is substantially something rather similar to capital stock. (There is a controversy as to the individual items composing the contents of this capital surplus¹⁵⁾, but I do not go into such details now.) And both of these, which are usually called *contributed capital*, are those which stockholders (investors) have contributed to, or invested in, as capital (principal) the company which is a capital organization composed of them. In other words, accordingly, they are in no sense *those which they have loaned to the company*. This is also evident in reality on a factual basis. On the other hand, earned surplus (especially that which is available through so-called internal reservation) is the profit obtained by the company or the stockholders which has been added to the abovementioned contributed capital, and therefore, to use an expression of capital, it is nothing else but a sort of added capital. Or, from the standpoint of stockholders, it should be regarded as representing a kind of forced investment (forced saving)¹⁶⁾. It may also be taken as self-evident that it is not through loan, either.

Furthermore, these owned capitals, seen from the *periodical* point of view, in their economic, substantial sense, apart from their legal sense, have the meaning of *principal* that is in possession of the company or stockholders in each period concerned. Therefore, if there is obtained *surplus* in excess of owned capital as such a principal in each period concerned, it should naturally be conceived as *profit* in view of what such surplus originally means. And it must be said that this profit, as a natural result when seen from its relation to the aforesaid owned capital, should be construed to belong to it.

3. Speaking of dividend in the first place for convenience sake among those which come into question in respect to the abovementioned theory of taking interest on total capital as expense or the theory of taking dividend as expense, it is a distinct fact to everybody at a glance that it is generally due to the profit as surplus as stated above. There is not room for its being regarded as expense in any sense. From such a fact, furthermore, the way of thinking in which dividend is regarded as *cost of capital* undoubtedly must be hard to approve. In fact it will have

15) As to my views on this point, see my articles: "Capital and Profit in Accounting", (3), (4), *Accounting (Kaikei)*, Mar. and Apr. 1958; "Rescrutiny of Various Items of Capital Surplus", *Business Accounting (Kigyo-Kaikei)*, Aug. 1960, etc.

16) For more details of my view on the way of understanding earned surplus associated with this, see my article: "Re-discussion of Premium on Shares and Promoter's Profit", (4), *Accounting (Kaikei)*, June 1959.

to be regarded as revealing with immediate clarity the capitalist way of thought.

I have already referred to it, on the other hand, that interest on owned capital—in the case of a joint-stock company—is practically included, in part or in whole, in dividend. And so far as this dividend is regarded as such as mentioned above, the character of interest on owned capital as well is to be easily known of itself. However, interest on owned capital, even when further viewed from itself, can be thought of only on the basis of the profit belonging to owned capital as stated above and it is nothing else but that. Moreover, it is obtained, generally as part of such profit, by every individual enterprise or its constituents, stockholders (other investors). When seen from such a fact, accordingly, it must be said that it should be regarded as evidently belonging to what we call business profit. Speaking from the other side of the matter, furthermore, this only means that the character of expense of such interest on owned capital, needless to say, should also be denied. For our part, accordingly, we shall have to know also that in such a respect, even if they are equally called interest, there exists an important difference between interest on owned capital and interest on borrowed capital.

Originally, it is because of interest on total capital=interest in general being grasped as expense, especially as so-called cost of capital that interest on owned capital is also taken as expense, but it must be said, in fact, that reconsideration is required first of all as to the very way of thinking about interest as stated above. As I have so far discussed as an issue, interest, so far as it is on capital, whether it is interest on owned capital or interest on borrowed capital, is, in any case, essentially due to surplus value or profit. In spite of that, however, that I insist that the character of expense should be recognized especially as to interest on borrowed capital alone when I consider the problem concerning the *profit of an enterprise as an individual economy* and *expense* associated therewith is solely due to the particular fact or basis as clarified above that it is on loan capital or borrowed capital (debt). Against it, interest on owned capital, so far as it should be regarded as belonging originally to profit attributable to owned capital=business profit, is nothing but *a sort of name* given to part of such business profit, and it must be said, therefore, that it is correct to understand it in that way¹⁷⁾.

In any case, however, as seen above, the view that not only interest

17) The disputants who identify owned capital with borrowed capital (loan capital), so far as they take interest on borrowed capital as expense, they are naturally, likewise, to take as expense interest on owned capital and dividend (in respect of dividend, at least the portion corresponding to interest on owned capital), but the disputants of this sort do not usually

on borrowed capital but interest on owned capital or dividend as well should be regarded as expense is often encountered at present. According to such a view, however, the concept of what we call business profit is forced to be unjustly narrowed. Moreover, interest on owned capital or dividend is in a large sum of money. Because of that as well, we, for our part, shall have to say that the aforesaid view that such interest on owned capital or dividend also should be regarded as expense should be made in particular an object of criticism.

insist on anything like the latter, either. No reason for that is given clearly in particular. Such being the case, we shall have to say that there is evidently a lack of consistency in their logic in the case of the disputants. We shall also be able to understand, however, that by *not arguing* that—unlike interest on borrowed capital—interest on owned capital and dividend should be taken as expense in that way, the disputants themselves, seen from the other side of the matter, are, in fact, expressing that interest on owned capital cannot be identified with borrowed capital (loan capital).